

TEACHERS' RETIREMENT BOARD  
INVESTMENT COMMITTEE

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SUBJECT: Update on State Legislation

ITEM NUMBER:   9  

ATTACHMENT(S):   2  

ACTION:   X  

MEETING DATE: April 5, 2000

INFORMATION:       

PRESENTER: Ed Derman

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**SUMMARY**

Staff has prepared the attached analysis and recommended position on the following measure for the Board's consideration:

<u>Attachment</u>	<u>Bill Number</u>	<u>Author</u>	<u>Subject</u>
1	AB 2745	Kaloogian	Public retirement fund investments: national security
2			Legislative Summary

**Assembly Bill 2745**

**Assembly Member Kaloogian (As introduced 2/25/00)**

**Position:**

**Oppose (Staff recommendation)**

**Proponents:**

**None known**

**Opponents:**

**None known**

**SUMMARY**

AB 2745 requires the internal and external fund managers of the California State Teachers' Retirement System (CalSTRS) and the California Public Employees' Retirement System (CalPERS) to perform and disclose due diligence on potential investments in foreign companies that pose a threat to national security. The bill also requires both systems to hire an independent auditor to (1) evaluate present and proposed investments in foreign companies and (2) report quarterly to their respective boards and the Legislature on such investments. The auditor may, when warranted, recommend divestment of companies posing a threat to national security. The reports would be available to the public.

**HISTORY**

Chapter 341, Statutes of 1999 (SB 105—Burton) required CalSTRS to report on investments in companies operating in Northern Ireland. The Board supported this bill.

Chapter 216, Statutes of 1999 (Hayden—SB 1245) required CalSTRS to report on investments in companies that owed compensation for victims of WW II era slave labor. The Board supported this bill.

**CURRENT PRACTICE**

CalSTRS does not currently require their internal and external fund managers to disclose their due diligence efforts with respect to current and proposed investments in any domestic or foreign companies. In these matters, fund managers have complete discretion. In return for that discretion, the fund managers have fiduciary responsibility for their investment decisions.

## **DISCUSSION**

Under AB 2745, CalSTRS and the CalPERS must require all internal and external fund managers to perform and disclose due diligence on potential investments in foreign companies and any threats to national security that those companies may pose. Both systems are required to hire an independent auditor to study, evaluate and report, publicly, on the present and proposed investments in foreign companies, specifically those believed to be involved in terrorism or the proliferation of weapons of mass destruction. The auditor may also recommend the divestment of investments in specific companies that pose a threat to national security.

The bill appears to include both public and private international equities within its provisions. About 50 percent of CalSTRS' international investments are passively managed. Recommending divestment of specific investments, however, results in an active investment strategy. An active management strategy for much of the system's investments would be expensive and would likely result in investments being concentrated in certain countries and companies that may or may not offer the best investment returns. This could result in potentially higher investment costs and increase risks to the Teachers' Retirement Fund. In addition, if implementation of this bill results in a reduction in the outside manager's discretion over investment decisions, CalSTRS would no longer have the fiduciary protection provided by the use of outside managers, and CalSTRS would assume fiduciary responsibility for the investment decisions.

Proposition 162 of 1992 amended the California Constitution to grant public employees' retirement systems sole and exclusive constitutional authority over their respective investment and administrative decisions. Under the Constitution, the duty of a public retirement system board to its participants and beneficiaries takes precedence over any other duty set forth by the Legislature. The bill requires the auditor to evaluate present and proposed investments in foreign companies. Requiring the manager to have proposed investments subjected to an auditor review will result in significant opportunity costs to CalSTRS because of the amount of time spent evaluating the proposed investment. In addition, because the auditor's recommendation would not apparently be based on any investment performance criteria, any actions by CalSTRS that resulted in a cost to the retirement fund would be inconsistent with the Board's fiduciary duty to operate on behalf of its members and beneficiaries.

## **FISCAL IMPACT**

Benefit Program – No net actuarial impact on the Teachers' Retirement Fund is expected.

Administration – The bill requires the Board to hire an independent auditor to study and evaluate present and proposed investments in foreign companies identified as threats.

CalSTRS has never employed a firm for the type of services required under the bill and is not aware of a firm that performs the duties required to develop the quarterly investment reports the bill requires. As a result, it is difficult to estimate the cost of these types of services, assuming they can be obtained. Large accounting firms that employ certified public accountants, for example, do not work with intelligence or national security related data in the normal course of things. Instead, these firms are in the business of computing and verifying only the accuracy of historical financial data.

## **RECOMMENDATION**

Oppose. The Board has plenary authority over investment matters and owes a fiduciary duty to CalSTRS' membership. Subjecting foreign investments to the type of review that is proposed in this bill would be inconsistent with that duty.

[illegible]

AB 107      AUTHOR:      Assembly Member Knox  
                  TITLE:      Tobacco divestment  
                  LOCATION:   Senate PE&R  
                  BOARD POSITION: Pending

**SUMMARY:** Prohibits new or additional investments in tobacco companies by CalSTRS and CalPERS on and after 1/1/01 in and total divestment by 7/1/02.

COSTS:      Benefit program – Pending  
                 Administrative – Pending

P – Author

0 – None known

AB 2745      AUTHOR:      Assembly Member Kaloogian  
                  TITLE:      CalSTRS and CalPERS investments in companies affecting  
                               national security  
                  LOCATION:   Assembly PER&SS  
                  BOARD POSITION: Oppose (Staff recommendation)

**SUMMARY:** Requires CalSTRS and CalPERS to hire auditors to evaluate and report on current and potential investments in foreign companies that pose a threat to national security.

**COSTS:** Benefit program – None  
Administrative – Undetermined cost to obtain auditor

P – None known

0 – None known

CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM  
LEGISLATIVE SUMMARY - INVESTMENT COMMITTEE  
**1999-2000 Regular Session – March 20, 2000**

[illegible]

SB 1928      AUTHOR:      Senator Haynes  
 TITLE:        Capital Markets Task Force  
 LOCATION:    Not yet assigned in Senate  
 BOARD POSITION: Pending

**SUMMARY:** Declares the intent of the Legislature to create a task force to oversee and review investments by CalSTRS and CalPERS to identify human rights, national security and other social concerns that could affect investment performance.

COSTS:      Benefit program – Pending  
                 Administrative – Pending

P – None known

0 –None known

SB 2122      AUTHOR:      Senator Ortiz  
 TITLE:      Joint Retirement System Investment Advisory Board  
 LOCATION:   Senate PE&R  
 BOARD POSITION: Pending

**SUMMARY:** Creates an advisory board to make recommendations to CalSTRS and CalPERS concerning asset allocation and active versus passive investments.

COSTS:      Benefit program – Pending  
                 Administrative – Pending

P – None known

O – None known

## LEGEND OF ABBREVIATIONS

P = PROPONENTS    O = OPPONENTS

<b><u>ABBREVIATION</u></b>	<b><u>ORGANIZATION</u></b>
AALA	Associated Administrators of Los Angeles
ACCCA	Association of California Community College Administrators
ACSA	Association of California School Administrators
AFSCME	American Association of State, County and Municipal Employees
AFT	American Federation of Teachers
AGENCY	State and Consumer Services Agency
A.R.E.	Association of Retirees for Equity
ART	Association of Retired Teachers
BOE	Board of Equalization
BOG	Board of Governors, California Community Colleges
Cal-Tax	California Taxpayers Association
CalPERS	California Public Employees Retirement System
CalPIRG	California Public Interest Research Group
CalSTRS	California State Teachers' Retirement System
CASBO	California Association of School Business Officers
CCA	Community College Association
CCAE	California Council for Adult Education
CCC	California Community Colleges
CFA	California Faculty Association
CFT	California Federation of Teachers
CNEC	California Network of Educational Charters
CPCA	California Police Chiefs' Association
CPFFA	California Professional Firefighters Association
CRTA	California Retired Teachers Association
CSAC	California State Association of Counties
CSBA	California School Boards Association
CSEA	California School Employees Association
CSL	California Senior Legislature
CSU	California State University
CTA	California Teachers Association
DOE	Department of Education
DOF	Department of Finance
DGS	Department of General Services
DPA	Department of Personnel Administration
FACCC	Faculty Association of California Community Colleges
F.A.I.R.	Faculty Attempting to Improve Retirement
FCPHE	Faculty Coalition for Public Higher Education
FTB	Franchise Tax Board
LADSA	Los Angeles Deputy Sheriffs' Association
LAUSD	Los Angeles Unified School District
OCDE	Orange County Department of Education

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<b><u>ABBREVIATION</u></b>	<b><u>ORGANIZATION</u></b>
PARS	Public Agency Retirement System
PERF	Public Employees Retirement Fund
RPEA	Retired Public Employees Association
SACRS	State Association of County Retirement Systems
SBMA	Supplemental Benefit Maintenance Account
SDCOE	San Diego County Office of Education
SEIU	Service Employees International Union
SLC	State Lands Commission
SSC	School Services of California
SSDA	Small School Districts' Association
START	State Teachers' Automation Redesign Team
TRB	Teachers' Retirement Board
TRF	Teachers' Retirement Fund
TRL	Teachers' Retirement Law
UTLA	United Teachers of Los Angeles

### **STANDING COMMITTEES OF THE ASSEMBLY/SENATE**

Assembly PER&SS	Assembly Public Employees, Retirement and Social Security
Senate PE&R	Senate Public Employment and Retirement